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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Leased Commercial Access	)	CS Docket No. 96-60

To: The Commission

COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

DISCOVERY COMMUNICATIONS, INC.

Donna C. Gregg
Todd D. Daubert
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Their Attorneys

May 15, 1996

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SUMMARY

As the owner of Discovery Channel, one of America's most popular cable networks, and The Learning Channel, one of the fastest-growing programming services, Discovery Communications, Inc. ("DCI") is proud of it successful record as a leader in development of high-quality educational and informational programming. With the launch of a new programming service -- Animal Planet -- imminent, DCI views proposed changes in the leased commercial access rules with grave concern.

Cable operators who have used the proposed "cost/market" formula to calculate leased channel rates indicate that adoption of the FNPRM will make leased commercial access available at nominal cost or for free. This can be expected to stimulate unprecedented demand for leased channels, which many sytems can accommodate only by displacing existing programming services or foregoing addition of new non-leased access services. Such a situation has the potential of undermining fundamental economic principles underlying the successful and diversified programming industry that exists today and on which the future growth and development of DCI's networks depend.

Through a business-plan type model used by established programming networks, DCI's comments demonstrate that the proposed formula greatly understates cable operators' lost opportunity costs from leasing channels by failing to take into account certain intangible but nonetheless substantial benefits of carrying non-leased access networks. As an alternative to the proposed "cost/market" approach, DCI supports a

formula based on the average implicit channel fee. In addition, the comments: (1) suggest a measure for avoiding excessive "bumping" of existing services (particularly when leased access programming duplicates programming already on the system); (2) seek Commission confirmation of the continuing validity of existing contractual carriage obligations; and (3) endorse a policy of flexibility in the channel positioning of leased commercial access programming.

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COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

Discovery Communications, Inc. ("DCI")[1] responds to the Further Notice of Proposed Rulemaking ("FNPRM") in the above-referenced Leased Commercial Access proceeding.[2] For the reasons set forth below, DCI has serious reservations about the proposed "cost/market" formula for determining channel leasing rates and related changes in the leased access rules. Thus, DCI's comments: (i) support an alternative to cost-based leasing rates; and (ii) suggest modifications to certain tentative conclusions reached in the FNPRM.

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[1] DCI, a diversified privately-held multimedia company, owns Discovery Channel and The Learning Channel. DCI also operates businesses in home entertainment, interactive multimedia, publishing, merchandising and international sales and distribution. Discovery Networks, a division of DCI, manages and operates both Discovery Channel and The Learning Channel.

[2] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992; Rate Regulation; Leased Commercial Access, MM Docket No. 92-266 and CS Docket No. 96-60, FCC 96-122 (rel. March 29, 1996).

I. INTRODUCTION

One of America's most popular cable networks, DCI's Discovery Channel reaches over 67 million cable households in the United States as well as a growing international audience. Through Discovery Channel and its rapidly growing sister network, The Learning Channel (serving 46 million U.S. cable households), DCI has become recognized for leadership and innovation in the development of high-quality educational and informational programming. This tradition continues with a new generation of viewing options through Your Choice TV and the recently announced launch of a new programming service -- Animal Planet.[3]

Despite this successful record, DCI has found that building and sustaining networks offering high-quality educational programming presents some unique challenges. Production costs of superior educational programs are high. For instance, the cost of Discovery Channel's Peabody Award winning original documentary, "Normandy: The Great Crusade," was 1.5 million dollars. When this program aired in 1994 in commemoration of the 50th anniversary of the D-Day invasion, it became the highest-rated prime-time program in Discovery Channel's history.[4] Despite the

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[3] Viewer research has demonstrated that many of Discovery Channel's viewers are huge fans of programs about animals, and place nature at the top of their list in terms of viewing preference. See Nielsen Personal NAD Facility, 4Q95 and 1Q96. Animal Planet will feature commissioned original product from many of the world's most respected producers of animal programming, including BBC Television, Survival Anglia and TV New Zealand.

[4] T. Shales, "Voices of the Invasion: The D-Day Specials that Truly Are," Washington Post, p. G1, June 4, 1994.

critical acclaim, it is clear that providing the public with such high-quality programming can be a costly endeavor.

The FNRPM's proposal threatens to undermine the economic foundation underlying DCI's efforts. Based upon operator assessments, the proposed, "cost-market" formula as well as certain tentative conclusions of the FNPRM appear capable of effecting a precipitous shift in the economic model on which the success and diversity not just of DCI's networks but the entire programming industry is based, by:

- dramatically reducing current channel leasing rates so that channels set aside for leased commercial access under the 1984 Cable Act can be had for a nominal amount, or, in certain cases, for free;
- skewing competition for already limited channel space in favor of commercial leased access, to the detriment of networks like Discovery Channel and The Learning Channel;
- forcing existing networks into an unfamiliar "landlord/tenant" relationship with cable systems, without adequate evaluation or planning;
- jeopardizing launches of new services like Animal Planet; and
- provoking a tremendous outcry from subscribers when they find that some of their favorite programming has been replaced with channels with no demonstrated audience appeal.

Certainly it is neither the Commission's responsibility under the Act[5] nor its intention in the current FNPRM to effect a market change of such sweeping proportions, to jeopardize the continued vitality of the programming industry or to

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[5] See S. Rep. No. 92, 102d Cong., 1st Sess. 29-32 (1991) and H.R. Conf. Rep. No. 862, 102d Cong., 2nd Sess. 79-80 (1992).

enrage subscribers. Nor is it necessary for the Commission to take such extraordinary steps to encourage leased access. The principal legislative purpose underlying leased commercial access is to increase program diversity by fostering diversity of programming sources.[6] As the Commission itself recently concluded, there already is a tremendous variety of programming available on cable systems, coming from a multiplicity of sources.[7]

Furthermore, it is not empirically obvious that leased access programmers will contribute to greater diversity on cable. In fact, if the type of programming being provided by advocates of major rate reductions is any indication, leased channels will be used for services in a limited number of formats[8]. Ironically, given current limits on channel capacity, some of the most original program offerings with the greatest diversity in audience appeal may be the first casualties of a sudden increase in demand for low-cost, leased channels.

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[6] See S. Rep. No. 92, 102d Cong., 1st Sess. 29-32 (1991); H.R. Rep. No. 934, 98th Cong., 2d Sess. 31-36, 47-48 (1984).

[7] In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Second Annual Report, CS Docket No. 95-61, FCC 95-942 at ¶ 150 (rel. Dec. 11, 1995).

[8] FNPRM at ¶¶ 19-20.

If, as the FNPRM states, the aim of the new rules is merely to insure that leased channel rates are reasonable,[9] DCI respectfully submits that there are options for doing so that will be much less disruptive. Specifically, DCI supports:

- retention of rates based on an implicit average channel fee as an alternative to a cost-based formula;
- a more gradual transition to new rates;
- preservation of the diversity of cable channel line-ups through restrictions on the "bumping" of existing services by channel lessees proposing to present substantially duplicative programming; and
- maximum flexibility for cable system operators in the positioning of programming.

II. There Are Insurmountable Difficulties with a Cost-Based Formula

Among several fundamental flaws in the assumptions underlying the Commission's "cost/market" approach, perhaps the most critical is the failure to take into account all of the cable operator's lost opportunity costs. The most glaring omission in this category is the cost to operators of the loss of subscribers and subscriber goodwill resulting from the removal or non-carriage of popular programming. It is axiomatic that displacement of popular programming from a cable system's line-up by programming in which subscribers have little or no interest will

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[9] FNPRM at ¶¶ 28 ("goal in determining a maximum reasonable rate should be to promote the statutory objectives of competition and diversity"), 63 ("A cost-based formula is not an attempt to influence demand or supply in any particular way."), 68 ("The purpose of the cost formula is not to lower rates.") .

diminish the overall value which subscribers place on the cable service as a whole and may even cause them to cancel their subscriptions.

While it may appear intuitive that a cable operator acting in its own best interest would not actually remove or displace popular programming, the reality of today's highly competitive programming market demonstrates otherwise. DCI argues that "displacement" should also incorporate the concept of delayed addition of desired programming that unreasonably low leased access rates will cause or compound. A primary example of the difficulty that even "popular" programming has in gaining access to cable carriage is The Learning Channel ("TLC"). TLC experienced considerable growth in carriage immediately following the Commission's adoption of the "going forward" rules in cable rate regulation because these rules stabilized the regulatory environment for cable operators and provided incentives to encourage operators to resume addition of programming services to any existing unused capacity, and to upgrade their facilities to expand capacity for more services. Since this surge in growth, however, TLC has, like other programmers, faced considerable difficulty in continuing to increase it subscriber base. Thus, TLC's audience reach currently stands at 46 million cable households as compared with Discovery's 67 million household audience. Despite the actual and demonstrable consumer demand for TLC,[10] many

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[10] Recent surveys show that TLC is one of the most highly-valued mid-sized cable networks among both cable subscribers of systems carrying TLC and subscribers of systems not carrying TLC. Beta Research Corp. Subscriber Study, 1995.

cable operators are still unable to add TLC due to capacity limitations. Skewing the marketplace by radically changing the leased access formula will only exacerbate the existing difficulties that quality program services valued by consumers, like TLC, face to gain access to cable carriage. The FNPRM acknowledges the existence of lost opportunity costs of this nature; however, because of the difficulty in quantifying them, the proposed formula completely fails to take such losses into account.[11]

Although the precise quantification of such losses may be difficult, there is undeniable evidence that the magnitude of such losses would be substantial. The significance of the threatened loss of subscriber satisfaction and loyalty is apparent from resources expended on attracting and keeping cable viewers. In Attachment A, DCI has constructed a model demonstrating the magnitude of well-established, popular networks' typical annual per subscriber investment in the development, production and acquisition of programming. The model also demonstrates that when a cable operator takes off a successful and popular programming service, it loses not just the audience appeal of the actual programming but substantial contributions to promotion and marketing that redound to the benefit of the cable service package as a whole. A programmer's investment in national advertising creates and promotes consumer demand for multi-channel video programming services that inures to the benefit of individual cable operators. What is more, programmers frequently supply systems with

[11] FNPRM at ¶¶85-86.

advertising materials for use in local advertising campaigns in both print and electronic media and assist cable operators in developing customized local marketing campaigns.

Attachment A offers a business plan-like model currently utilized by many programmers seeking access to cable carriage on a basic or enhanced level of service. Assuming a "popular" service, it is reasonable to presume a total cable distribution of 60 million subscribers (slightly less than Discovery Channel's current distribution). The total revenue projected is the sum of license fee revenue and advertising sales revenue. Based on DCI's experience, it also is reasonable to presume a revenue of $300 million annually for a "popular" service that is carried on a basic or enhanced level of service (critical to support advertising revenue projections).

Thus, the annual revenue generated per subscriber is $5.00. To determine profit, it is necessary to subtract the program investment costs and the local and national promotion nd marketing costs. Again, based on DCI's experience, the model shows an annual profit of 50 cents/subscriber for a service with a high investment in programming and marketing.

Under this model, the value of access to carriage on the basic or enhance level of service of a cable system with 10,000 subscribers is $50,000 annual gross revenue, or $5,000 profit (representing a 10% return, which seems reasonable to presume for an established service. Access to the basic or enhanced level of service of a cable system servicing 100,000 subscribers is worth $500,000 in gross revenue, or $50,000 in profit to the established programmer.

When a cable system is forced to delete a popular programming service to accommodate leased access (or is unable, due to capacity constraints, to add a service that its viewers wish to see), the cable operator has no assurance that the channel lessee will devote resources to programming and promotion comparable to the resources that would have been invested by the deleted or omitted network. In fact, in light of the economic realities of channel leasing, it is highly unlikely that a channel lessee would do so. Successful networks developed based on the prospect of ultimately enjoying dual revenue streams. Thus, under the current economic model, they are able to spend considerable amounts on these crucial program and marketing functions. In contrast, even when the cost of leasing a channel is low, a typical leased access programmer lacks any prospect of revenue from subscriber fees. This dramatically reduces resources available to invest in programming and marketing support. For these reasons, a channel leasing model typically will be most viable only where the programmer has low program costs (for example, an infomercial channel where programming consists of program-length commercials provided or funded by advertisers) or a combination of a low cost format and another revenue stream (for example, a shopping channel).

The programmer's contribution of program investment, promotion of its network and, often, direct local marketing support simply is too important to a cable system's overall subscriber appeal to exclude from lost opportunity costs merely because it is difficult to quantify. The absence of this component is so significant that the resulting lease rate utterly fails to achieve the statutory goal of fairly compensating the cable operator for loss of the ability to make use of the channel. This fatal flaw in the cost-based approach for determining channel lease rates is a compelling reason for the Commission to pursue a different approach.

III. There Are Important Advantages to a Rate Formula Based on an Average Implicit Channel Fee as an Alternative to a Cost-Based Approach.

The apparent impetus behind the instant FNPRM is a few programmers' claims that current leased channel rates are "prohibitive" and, thus, in their view, do not meet the statutory test of reasonableness. These same petitioners argue that the relatively small amount of access usage demonstrates that current channel lease rates are too high.[12] Because of their adverse impact on cable systems, the programming industry and subscribers, it is difficult to see how the "zeroed out" rates produced by the "cost/market" formula in the FNPRM are any more reasonable. Furthermore, because of inherent difficulties in quantifying a major cost component of leased access, tinkering with a cost-based formula is unlikely to produce a unsatisfactory formula. Thus, DCI supports retention of the current, implicit channel fee method, using the average rather than the highest fee.

[12] FNPRM at ¶ 19. Yet the Act expressly contemplates the possibility of low demand and non-utilization of all set-asides by specifically allowing cable operators to program set aside channels in the absence of leased access demand. See 47 U.S.C. § 532(b)(4).

An additional significant and troubling omission from any calculation of lost opportunity costs under the "cost/market' approach is the value to the cable operator of its editorial freedom to select its program offerings. While we recognize that such a value also is difficult to quantify, DCI submits that this value is, in fact, inherently incorporated in the "implicit fee" approach. The amount of money that a cable operator is willing to spend on program license fees in today's highly competitive programming market, while not a one-for-one measure of a network's worth, nevertheless bears a direct correlation to that operator's assessment of the value that the programming selected brings to the cable service as a whole. Program license fees are heavily negotiated, thus providing a true indication of the intangible value to the cable operator of its ability to select program offerings from a variety of suppliers seeking carriage. Given the fact that many new program services defer initial license fees to gain access to limited channel capacity, it is obvious that the lowest implicit fee -- zero -- is unreasonable because it does not reflect the value of more established services.

Given the tremendously high value to cable programmers of gaining access to a cable system, it is arguable that the low level of leased access usage alone does not necessarily confirm that the current implicit fee formula is unreasonably high. DCI recognizes the Commission's concerns, however, and suggests that rather than abandoning the implicit fee model altogether, a more moderate and less disruptive approach would be to lower leased access rates by adopting a formula based on the average implicit fee. DCI believes that such a model would, by definition, capture some of the intangible values and lost opportunity costs that the "cost/market" approach is unable to incorporate.

From the Commission's perspective, this alternative has other important advantages. First, it will reduce current rates, thereby making them more "reasonable" from the viewpoint of petitioners seeking lower cost access. As the Commission acknowledged in adopting the implicit channel fee approach in 1992, the formula also is relatively simple to use, and the resulting rates are relatively easy to verify[13]. Finally, although the lower rates produced by this alternative formula might well stimulate some additional demand for leased channels, it will not provoke the disruption, instability and adverse consumer outcry that would result from a sudden deluge of leasing activity if leasing rates were reduced to the extent likely under the "cost/market" approach.

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[13] Report and Order and further Notice of Proposed Rule Making, MM Docket No. 92-266, FCC 93-177, 8 FCC Rcd 5631, 5952 ¶ 522 (1993) ("Rate Order") ("Maximum rates will not only be readily determinable by each operator with no burdensome accounting and costing requirements, but they will also be easily verifiable by regulators. . . ").

IV. The Leased Access Rules Should Seek to Avoid Unnecessary Program Disruption

A. There Should Be a Reasonable Limitation on "Bumping" of Existing Services.

DCI has invested heavily in high-quality and innovative programming in order to earn a place for its networks in cable systems' crowded channel line-ups. Until more cable channels become available, DCI expects to face ever-increasing competition for channel space so that Discovery Channel can maintain its high level of cable distribution, TLC can continue as one of the fastest-growing basic cable networks, and Animal Planet and other new services can begin to build an audience. DCI is willing to engage in fair competition for distribution; however, for the reasons stated above, the FNPRM's proposal would give leased programming an unfair advantage over existing programmers and new services that choose not to proceed under a leased access model.

Since the inception of the leased access requirement in 1984, some displacement of existing programming was possible. But the public interest is not well served by encouraging displacement of popular programming by leased channels that contribute nothing to increased program diversity. Accordingly, DCI suggests that during a limited transition period of five years (after which technological advances and system expansion should begin to ease the current shortage of capacity), programmers leasing channels at new, lower rates should not be permitted to "bump" existing channels when the leased programming substantially duplicates programming already carried by the cable system.

Congress recognized the public interest benefits of exluding duplicative programming from other channel entitlements conferred by the Act. Thus, for example, the Act's must-carry provision does not require cable operators to carry more than one local commercial television station affiliated with a particular broadcast network or to carry the signal of a local television station that substantially duplicates the signal of another local television station. See 47 U.S.C. §§534 (b)(5) and 535 (a)(3)(c) and (e). A similar approach would prove beneficial in a leased access context.

B. Leased Access Should Not Be Accommodated at the Expense of Contractual Carriage Rights.

Like many programmers, DCI seeks to protect its networks from being bumped from existing carriage in negotiating affiliation contracts. Nevertheless, a sudden and dramatic increase in demand for leased channels may pressure operators to free up occupied channel space irrespective of contractual obligations. The Commission should make it clear that its rules do not affect existing contract provisions in that compliance with leased access obligations neither compels operators to abrogate existing contracts nor excuses cable operators from adhering to their contractual carriage commitments.

V. The Current Policy Covering Placement of Leased Channels Should be Retrained.

DCI respectfully takes issue with the FNPRM's tentative conclusion that leased access programmers have a right to be placed on any particular tier.[14] Unlike placement of "PEG" access and must-carry channels, the channel position of leased access programming is left to lessor/lessee negotiation. The FCC declined to alter this policy in implementing the leased access provisions of the 1992 Act. There are several compelling reasons not to disturb this policy. Because the continued popularity of basic and enhanced basic packages makes carriage on those tiers extremely valuable, channel placement figures prominently in program contract negotiations of non-leased access programmers. Networks like Discovery Channel and The Learning Channel must earn their tier placement through investment in programming and subscriber ratings. Giving immediate and automatic access to such highly-coveted channels to leased programmers who have not yet demonstrated their value to subscribers would only add to such programmers' unfair advantage over existing and new non-leased programming services.[15] In addition, if channel positions are not mandated, cable

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[14] FNPRM at ¶¶ 118-119.

[15] DCI has previously requested further refinement of rules allowing minority and educational programming carried in substitution of leased access in accordance with §612(i) of the Act, 47 U.S.C. 532(i). FNPRM at ¶131. Specifically, DCI argued that such substitute programming should be placed on a widely-distributed tier in order to fulfill the statutory purpose of the substitution option. Because entirely different policy considerations underlie the placement of commercial leased access channels and minority/educational programming, DCI's request in no way concedes or recommends that leased access channels are entitled to similar carriage.

operators can attempt to minimize the amount of disruption to existing carriage when leased channels are added.

VI. CONCLUSION

The proposed "cost/market" formula is fundamentally flawed. It has a very real potential for: (i) forcing cable operators to make channels available without adequate compensation; (ii) giving leased commercial access an unfair advantage by making channels available at rates far below market value; (iii) stimulating a sudden, unprecedented demand for low-cost channel leases; (iv) driving popular existing programming from cable channel line-ups and making it impossible for new, non-leased access programmers to build audiences; (v) provoking a huge outcry from cable subscribers; and (v) undermining fundamental economic conditions on which a very successful and diverse programming industry has been built. To avoid such a major upheaval, an alternative to the proposed formula is needed. Such an alternative is available. DCI respectfully urges the Commission to consider retention of the current, implicit channel fee approach, with certain modifications, as well as to adopt limits on "bumping" of existing services by duplicative leased access programming, to confirm the continuing validity of contractual carriage obligations and to revisit its tentative conclusions concerning channel positioning of leased commercial access.

Respectfully submitted,

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A

Current Cable Programming Market Model

Discovery Plan

Illustration: **A Popular Channel**

60,000,000	$300,000,000	$5.00	$50,000	$500,000
		$3.00	$30,000	$300,000
		$1.50	$15,000	$150,000
		$0.50	$5,000	$50,000